Options for Smoothing BSCCo Costs

BSC Panel

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Summary

Following feedback on the budget contained within our business plan, Elexon agreed to explore options for smoothing year on year costs. This paper discusses the rationale which subject to Panel discussion, would need to be explored with industry

1. Introduction

1.1 Elexon welcomes the comments received from industry in response to the publication of the business plan and during business plan webinar.

1.2 Following the comments made by the Panel as part of industry's review of our business plan, a decision was taken to look at what viable options, if any, exist to address the periodic spiking of costs, particularly in years where significant investment is being made around technology (either as part of our strategy or due to "Demand Led" industry change). The current challenge is a consequence of the funding model that exists for Elexon, which creates certain constraints relating to access to capital across years.

1.3 This paper firstly discusses the presumed issue(s) that give rise to an interest in rolling forward underspend and invites discussion at the Panel determine the appetite amongst industry for such changes.

1.4 For the avoidance of doubt, any consideration regarding the smoothing of costs would be in relation to significant investment areas of our budget such as Demand Led or System Strategy, not the operational and contracted costs that are part of running "business as usual".

2. Considerations

2.1 As mentioned in the introduction above, Elexon operates under certain constraints that exist within the Balancing and Settlement Code. In particular, under-spend in any given financial year cannot be retained, and must be returned to BSC Parties. Whilst the Board and Executive have control within year, through the management of the forecast, which in turn drives the monthly billing, and therefore can be used to control/affect liquidity, this is not an available option across fiscal periods.

2.2 It should be recognised that we have always returned underspend and the more material amounts have in the past been attributable to unspent Demand Led funds. These are funds budgeted for industry led change. Where the volume of change has not materialised this has resulted in underspend. However, more recently due to the size of our Systems Strategy investment and delays to parts of that programme, the volume of underspend has increased. These delays have given rise to the situation where funds are given back then asked for in the next year. It is recognised that one way to resolve this issue is for Elexon to deliver all that it budgets for but as there will always be uncertainty and variances, we believe we first must explore the appetite of industry and then, assuming there is appetite, discuss with them any appropriate options.

The Issue for Industry:

a) In its response to the Business Plan the Panel requested that Elexon considers whether there is an alternative to returning unused budget to BSC Parties: 'We have some concern that returning funds in this way could lead to 'lumpy' funding requests in major investment programmes such as Kinnect. The Panel would be supportive of Elexon exploring ways which would allow Parties to smooth this out – either in their own accounting processes or in Elexon's.'

b) We have interpreted this as a desire to explore retaining underspend to roll it over to the following year. This avoids returning funds unused due to delay and then immediately asking for them again in the following year's budget.

c) An alternative approach could be the smoothing of funding requirements across years, whereby instead of fluctuating budgets, funds are made broadly equal across the duration of the project. However, this would only work if more funds were requested in the early years and kept for later years (since in the absence of any other borrowing, Elexon could not fund a shortfall in the early years and fund it from future years). Given that we are half way through Kinnect investment, if retaining unspent budget was seen as a solution for an industry concern relating to fluctuating funding requirements, it may have been best addressed in the years before embarking on the significant investment programme we now have. For the avoidance of doubt, this was considered but due to the existing constraints we did not explore this further. It is assumed that as this would require Parties to fund higher amounts in the early years, which is the opposite of their expressed concerns, this would not be supported so this is not explored further.

d) A further alternative interpretation is funding change ahead of need. This would involve industry funding an investment ahead of need (and ahead of the year in which the expenditure is required) such that the annual funding need is smaller (although it would start earlier and last longer). This is not considered attractive to industry and is not explored further.

However, we are reluctant to presume the driver and therefore need to firstly explore this with Panel (and if Panel considers it worthwhile, with industry). It should also be noted that there is a contradiction in purpose of the first as opposed to the second and third alternatives above; i.e. the alternatives cannot be addressed with the same solution and/or worse, a solution for one makes the other issue more acute.

Industry reaction

e) Parties may assert that we are "padding" out our budgets in order that we can build up a war chest. This might be mitigated by permitting retention only of system strategy or demand led funds (and not operational underspend) and/or restricting the activities on which underspend could be used (e.g. to the same type of activity for which it was originally provided and expressly not for 'new growth activities'), and/or specifying a maximum or other criteria and administrative hurdles. However, this introduces further complications and the need for reporting and transparency with additional administrative burden.

f) There is always the risk that underspend rolled forward is not spent in the following year. This would result in potentially two years of underspend with no give back in the first year and a double size give back in year two, with the criticism that we have sat on industry monies for two years.

Impact on budget

g) Enabling us to retain funds would not be able to apply retrospectively - The current year's budget has already been approved, and therefore it is unlikely we would be able to augment the budget for 2021/22 at this late stage. In addition, whilst we have a good track record of operating within budget, the Kinnect investment for next year has started in earnest, and if anything the coming year is likely to be tighter than recent history i.e. there is less chance of underspending on systems strategy in 2021/22.

h) Budget setting - For underspend in year x to have an impact on reducing the budget for year x+1, we will need to determine in say Oct/Nov of year x what the under spend for the whole of year x is likely to be and then deduct it from year x+1 budget before we issue that budget for comment. As well as being administratively difficult, that would also be risky at a point where uncertainty around remaining costs for year x still exists. This could be overcome by being clear that this approach wouldn't actually impact budgets of year x+1, only charges in year x+1. It does mean though that actual compared to budget for year x+1 would be a larger gap than might exist under current arrangements.

Process:

i) Any change would require a modification to the code. It is considered unlikely that this would fall within the powers of Modifications permitted to be raised by the Panel and so would require an industry proposer. Hence the need to gauge what appetite industry would have for this.

3. Recommendations

3.1 The Panel is invited to:

a) **DISCUSS** the issue that it believes is in need of being addressed as set out in one of paragraphs 2(b), (c) and (d) above (noting that they are mutually exclusive); and

b) **DECIDE** whether, in light of the considerations set out in this paper, to explore further through industry engagement.

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